Saudi Arabia Commercial Market Review

Autumn 2022

OFFICE MARKET

RIYADH

Demand for office space is increasing at unprecedented rates in Riyadh, fuelled by an influx of businesses to the Saudi capital. According to data published by the Ministry of Investment of Saudi Arabia (MISA), the number of foreign investment licenses issued during Q2 2022 stood at 4,455 – a 673% rise on Q2 2021. Separately, FDI levels hit SAR 3.5 billion during Q2, across 49 deals (up from 37 in Q1), which has created 2,000 new jobs and was led by the UK, UAE, Jordan and the USA (MISA).

The record high level of investor's interest in the Kingdom comes in the wake of the widely publicised fact that Saudi Arabia is set to have the world's fastest growing economy, which is proving to be very tempting to international businesses looking for ways to mitigate against weak and stagnant economies elsewhere in the world. Indeed, this positive economic sentiment has left the country's non-oil sector PMI in a state of expansion for almost two and a half years, highlighting that businesses continue to expand and recruit. Meanwhile, confidence in future economic growth currently stands at its highest level since the start of 2021.

In addition, Program HQ is gaining further traction, with 70 international businesses committing to establishing their Middle East headquarters in Riyadh since the launch of the scheme. This includes the likes of Aldeham Education Group (AEG) and French rolling stock manufacturer Alstom.

Unsurprisingly, office lease rates continue to climb in the wake of growing demand. Indeed, average lease rates for prime office space have increased by 18% over the past year to approximately SAR 1,775 psm. Occupancy levels stand at 98%, underscoring the depth of demand for office space. The heightened demand means landlords are firmly in the driving seat.

Grade B rents are also on the increase as occupiers jostle for space in the Saudi capital. With limited Grade A options, many are either turning to the Grade B market or exploring build-to-suit options. Average Grade B rents are up 10% in the last year. High requirement levels in prime commercial locations such as King Fahad Road and Olaya Street have lifted Grade B rents here by 6%, while city-wide Grade B occupancy levels now stand at 75%; the highest level in at least five years.

JEDDAH

Echoing Riyadh, Jeddah's office market has also been experiencing a resurgence in requirements as multinational and domestic businesses ramp up their presence in Saudi Arabia's second largest city. As is the case elsewhere in the world, the focus is on best-in-class Grade A offices, however the lack of supply and rising costs mean many businesses are exploring Grade B space as well.

Grade A office rents stand at around SAR 1,065 psm, reflecting a 6.5% increase on this time last year. Grade B rents have increased by 8.5% over the same period. Vacancy levels continue to edge downward, standing at 8% for Grade A offices and c. 20% for Grade B buildings.

The lack of any supply of notable quantum, combined with the upward creep in demand suggests rents will continue to rise. Indeed, just two small office buildings have completed in 2022 so far, taking the total volume of office space to 1.2 million sqm. By 2024, we forecast an increase in total office space by 8%. This already low figure is likely an overestimate given the history of construction timeline delays, again pointing to continued buoyancy in rents.

Looking ahead, the recent announcement of the formation of the Jeddah Governorate Development Authority is likely to drive up demand further. The newly formed authority plans to work with local entities to develop initiatives to attract businesses and also to deliver commercial office projects to satisfy the high levels of demand.

DMA

The positive economic sentiment has also impacted office demand in the Eastern Province. Rising requirements for offices in the Dammam Metropolitan Area (DMA) has driven up lease rates for Grade A space by 5% in the last 12 months to SAR 950 psm. With the demand focussed on best-in-class space, Grade A occupancy levels have edged up to 77%, from 73% last Autumn.

While landlords of Grade B offices continue to remain flexible with lease terms and headline rents, vacancy levels rose by 2 percentage points to reach 42%, but rents remain stagnant at SAR 575 psm.

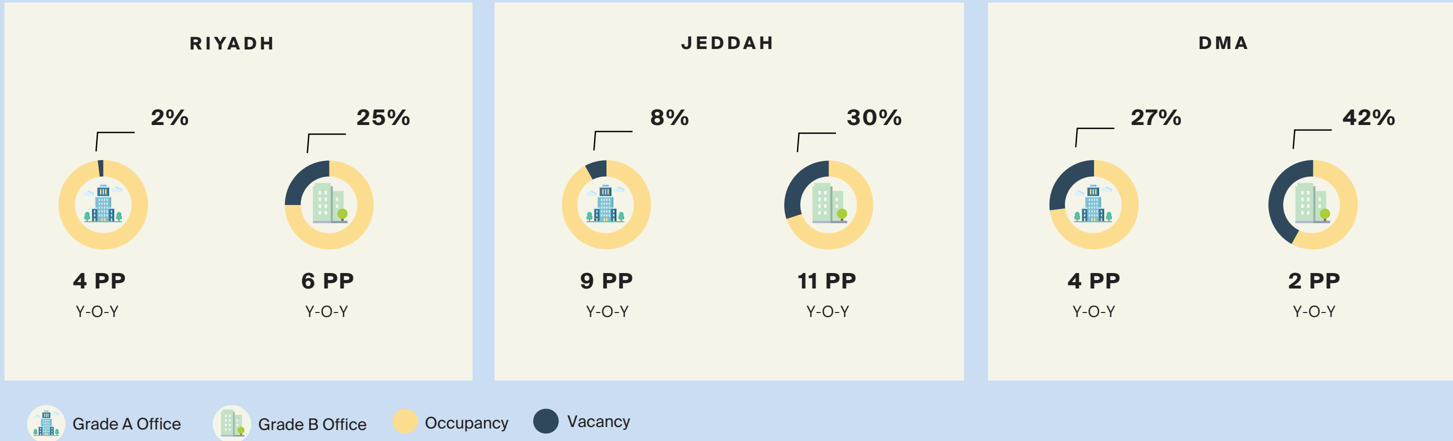
In terms of supply, the current total office stock for DMA stands at around 1.3 million sqm, 45% of which is classed as Grade A. 100,000 sqm is forecast to be completed by the end of 2024. The additional supply is expected to exert downward pressure on Grade B office rents as the flight to quality shows no signs of slowing or reversing.

MARKET PERFORMANCE INDICATORS

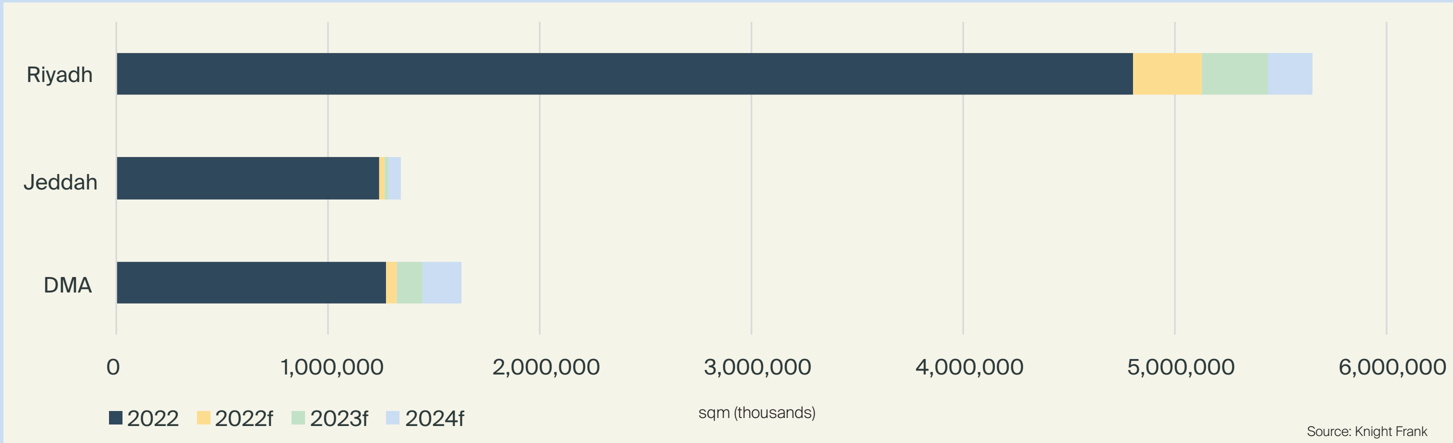
Grade A and B rental rates and YoY % change as at Q3 2022

	RIYADH		JEDDAH		DMA	
	GRADE A	GRADE B	GRADE A	GRADE B	GRADE A	GRADE B
SAR/sqm	1,775	868	1,065	750	950	575
Y-O-Y	18.3%	10.6%	6.5%	8.5%	5.6%	-0.2%

Grade A and B vacancy as at Q3 2022



Forecast office supply



Source: Knight Frank

RETAIL MARKET

RIYADH

Of the total new licenses that were awarded to new foreign investment projects in Q2 2022, 60% are within the wholesale and retail trade sector. The appetite of international retailers to operate and enter the Saudi market continues to strengthen, with a preference for physical stores in shopping centres. Some are also rapidly establishing Saudi-specific online platforms to tap into the boom in online shopping in the wake of the pandemic. Indeed the Saudi Central Bank reported recently that the value of online transactions nationally has risen 77% since the start of the pandemic.

Retail spending in Riyadh started recovering in 2021 post-pandemic, with a 4% increase reaching 1.066 trillion, according to Oxford Economics. Their forecast indicates that retail spending will continue rising at an average rate of 3% until 2024. Demand for retail in the capital is locally driven, and as the population continues growing, it is expected to strengthen over the next few years. Additionally, the rising number of visitors to the city will continue contributing to the retail sector positively.

In terms of Supply, in Riyadh alone, around 400,000 sqm of retail space has entered the market so far this year. We expect the total retail stock in the city to rise from 3.6 million sqm at present to close to 4.3 million sqm by 2024, representing a 25% increase. It is too early to forecast whether the high volume of new space will be readily absorbed, but for now our expectation is for rents to remain under downward pressure.

JEDDAH

Like Riyadh, rental rates in Jeddah's retail market dropped during Q3. In both super regional and regional malls, lease rates have declined by an average of 3% over the past 12 months.

As consumer preferences change, most retailers are gravitating towards new, trendier locations such as Atelier La Vie and City Yard. This pivoting of demand is prompting some landlords of older retail units to incentivise existing tenants to renew leases in situ by offering rental discounts. Others are using the increasing vacancy levels to refurbish their properties, while also incorporating F&B outlets, or entertainment – some through pop-up events - to cater to a wider range of customers, most of whom are seeking lifestyle destinations where shopping is almost a secondary priority, behind leisure and entertainment offerings.

Total existing retail supply in Jeddah stands at 2.2 million sqm and is comprised of mainly regional malls (38%) followed by community retail centres (32%) and super regional malls (21%). We expect 520,000 sqm to be delivered by 2024, taking the city's total to 2.7 million sqm. The bulk of new supply will come in the form three super regional malls: Souq 7; The Village; and Jawharat Jeddah.

DMA

Retail requirements in the DMA remain weak, with demand concentrated on super regional malls. That said, larger, well-managed shopping centres are maintaining demand, highlighting the importance placed on good property and facilities management by retailers, especially those of an international flavour.

In addition, and just like the story playing out in cities around the world, landlords and developers are directing their focus towards attracting tenants through the uniqueness of their entertainment and F&B offerings. One such example is the 15,000 sqm Khobar City Walk development that was recently completed and is understood to have been leased shortly after opening.

Market-wide occupancy levels have edged up by 2 percentage points over the last 12-months and currently stand at 91%. Rents remain static at approximately SAR 2,300 psm, up 0.5% over the same period.

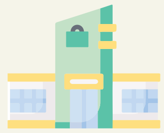
The marginal change to occupancy levels is in part due to the completion of 42,000 sqm of space so far this year, which has lifted the city's total retail stock to 1.2 million sqm. A further 590,000 sqm is likely to be delivered by 2024, with the developments such as Al Shobily Grand Mall (150,000 sqm).

MARKET PERFORMANCE INDICATORS

Retail market lease rates as at Q3 2022

RIYADH

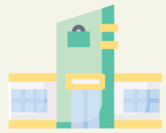
2,645
SAR/sqm



Regional/Super-Regional mall
-1.3%
Y-O-Y

JEDDAH

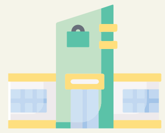
2,669
SAR/sqm



Regional/Super-Regional mall
-2.7%
Y-O-Y

DMA

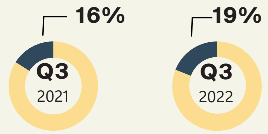
2,299
SAR/sqm



Regional/Super-Regional mall
-0.4%
Y-O-Y

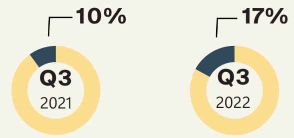
Retail occupancy rates

RIYADH



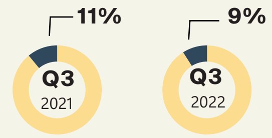
-3 PP
Y-O-Y

JEDDAH



-7 PP
Y-O-Y

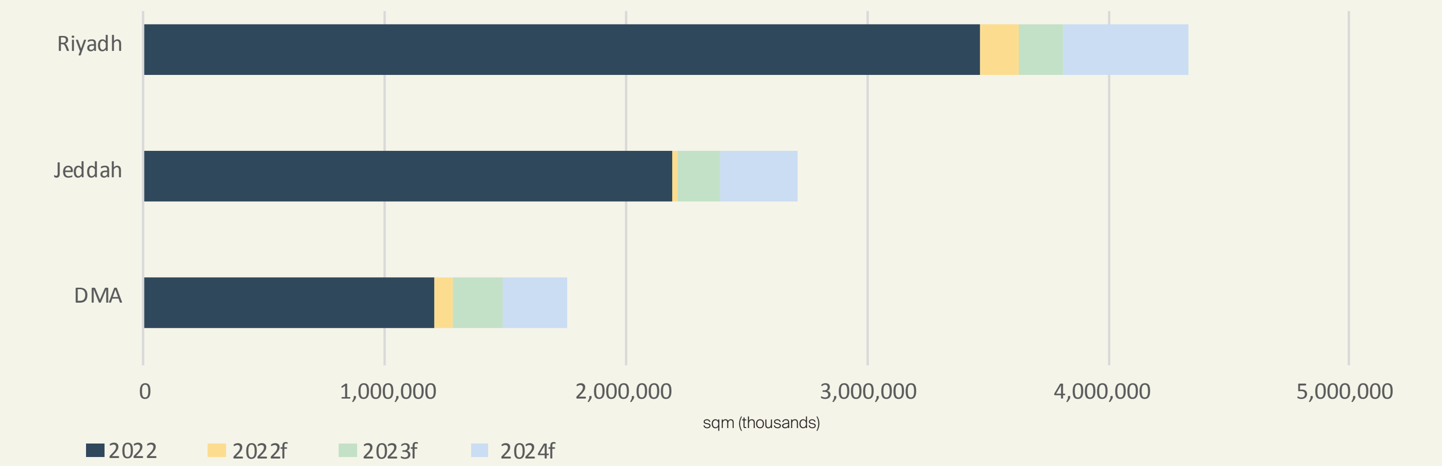
DMA



-2 PP
Y-O-Y

Occupancy Vacancy

Forecast retail supply



HOSPITALITY MARKET

RIYADH

In addition to Riyadh Season, the return of a variety of events previously suspended due to the pandemic is sustaining and boosting visitor arrivals. For instance, the recent Riyadh International Book Fair, widely promoted as Saudi's largest cultural event, attracted over 1 million visitors from across the nation. Contributing to improving occupancy rates in the capital's hotels. Furthermore, rising activity amongst international corporates relocating or expanding their presence in Riyadh has also boosted business travel.

As a result, between January and August of 2022, the city's average occupancy levels rose to 58%, a 10% increase on the same period in 2021. Average Daily Rates (ADRs) have also edged higher to SAR 634 per night, from SAR 515 per night last year. Importantly for hoteliers, Revenue per Available Room (RevPAR) is up 36% year on year and now stands at SAR 367 (STR Global).

Looking forward, with the recent launch of the third edition of Riyadh Season, we expect the strong demand for hotel rooms this winter. Additionally, as noted above, with rising business travel, room rates are expected to continue rising across the city.

To cater to the growing demand and as part of the economic transformation plans, a myriad of new hotel offerings are being planned to accommodate the government's forecast increase in visitor numbers. We expect the total number of hotel rooms to rise by around 25% to 25,000 keys by the end of 2024, with over half of the upcoming supply expected to be internationally branded and operated.

JEDDAH

The resumption of Jeddah Season has had a positive impact on the city's hotel performance. The latest edition of the entertainment extravaganza, which stretched for three months during the summer attracted over 5 million visitors to the city, drawn in by the 2,800 scheduled entertainment and cultural events.

The usual hospitality market KPIs reflect the surge in visitor numbers. Between January and August, Jeddah's ADRs reached SAR 804, up from SAR 685 last year. During the same period, occupancy levels increased by 10% to 56%, while, RevPAR surged by 30% to reach SAR 452, almost 25% higher than Riyadh (STR Global).

Besides the main entertainment season, several smaller events are also emerging throughout the year, such as the second edition of the Saudi Coffee Festival, which is contributing to the city's appeal amongst domestic tourists. This of course in addition to the usual demand from the two million pilgrims that arrive in the holy cities of Makkah and Madinah each year for religious pilgrimage.

In terms of supply, counting only projects that commenced construction, by 2024, around 4,800 quality hotel keys are expected to come online. The additional supply will represent a 35% increase from the current number of keys.

DMA

In contrast, but in line with seasonal trends, DMA has experienced its usual summer lull, with all the hospitality market indicators we track slipping. Between January and August, ADRs fell by 3.4% to SAR 416. Similarly, Occupancy levels declined to 52%, down 5 percentage points on the same period last year. RevPAR also weakened to reach an average of SAR 215.

The total quality hotel supply increased to over 12,000 keys during the third quarter of 2022. Assuming no further delays, and considering only projects that have broken ground, the total supply is expected to increase by 21% by 2024.

Looking ahead to the rest of the year, the DMA's hospitality market is expected to experience a 2022 FIFA World Cup linked fillip. Following the government's recent announcement to allow Qatar World Cup ticket holders easy access to multiple entry Tourist Visas, Saudi is expecting to play host to some of the football fans unable to be accommodated in Qatar. DMA's close proximity to Qatar and relative affordability is expected to make a popular alternative to cities such as Dubai, Abu Dhabi and Manama.

MARKET PERFORMANCE INDICATORS

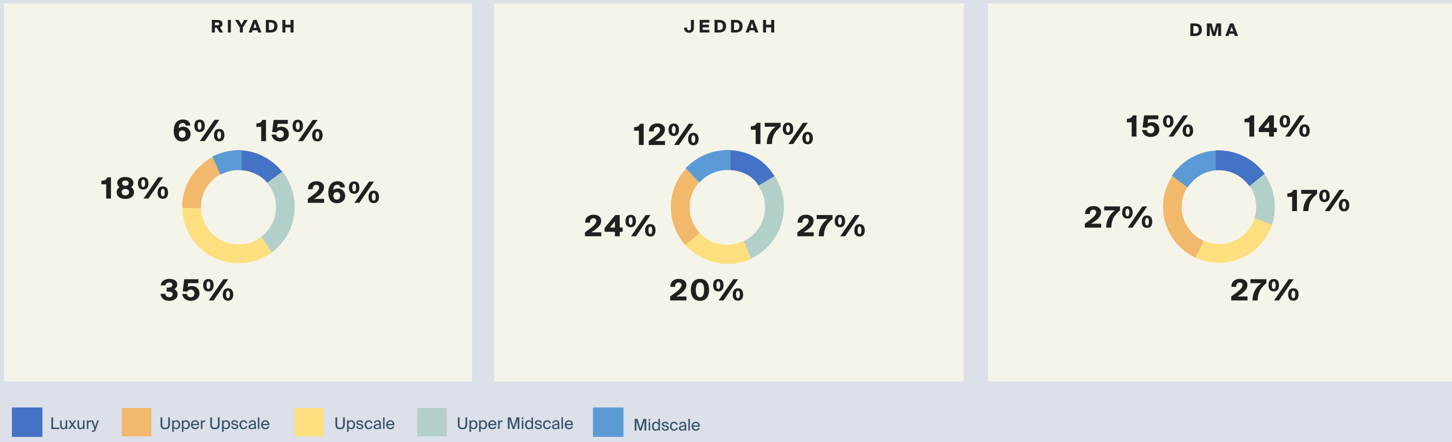
KPIs - ADR, Occupancy and RevPAR - Y-o-Y % change YTD Q3 2022

RIYADH
ADR 23.3%
OCCUPANCY 9.9%
REVPAR 35.5%

JEDDAH
ADR -17.4%
OCCUPANCY 10.5%
REVPAR 29.7%

DMA
ADR -3.4%
OCCUPANCY -5.1%
REVPAR -8.4%

Existing quality hotel supply market segmentation YTD Q3 2022



Existing and upcoming quality hotel supply

RIYADH
19,914 KEYS
EXISTING SUPPLY
+25%
INCREASE IN SUPPLY UNTIL 2024

JEDDAH
13,734 KEYS
EXISTING SUPPLY
+35%
INCREASE IN SUPPLY UNTIL 2024

DMA
12,327 KEYS
EXISTING SUPPLY
+21%
INCREASE IN SUPPLY UNTIL 2024

Source: Knight Frank, STR Global

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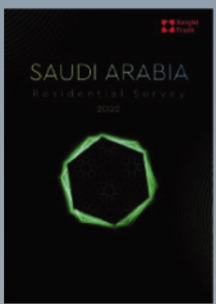

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